

Message Text

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NSAE-00 NSC-10 PA-04 RSC-01 PRS-01 SPC-03 SS-20 INT-08

FEA-02 IO-14 AID-20 COME-00 FRB-02 TRSE-00 XMB-07

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FM AMEMBASSY LUXEMBOURG

TO SECSTATE WASHDC IMMEDIATE 3716

INFO AMEMBASSY BRUSSELS

C O N F I D E N T I A L SECTION 1 OF 2 LUXEMBOURG 0038

STATE ALSO FOR T/IEP

E.O. 11652: GDS

TAGS: EFIN, ECON, ENRG, OECD

SUBJ: ENERGY: FEBRUARY 11 FOREIGN MINISTERS MEETING
ON INTERNATIONAL ENERGY PROBLEMS

REF: STATE 7324

RESPONSES TO REQUEST ARE KEYED TO PARAGRAPH SIX OF
REFTEL:

A) MONETARY AND FISCAL POLICIES

1) OUR SOURCES IN THE ECONOMIC MINISTRY INDICATE THAT
THE GOL INTENDS TO USE THREE MAIN POLICY TOOLS TO COMBAT
ECONOMIC DISTORTIONS AND PRICE INCREASES STEMMING
FROM SHORTAGES IN PETROLEUM SUPPLIES AND INCREASED
PETROLEUM PRICES: PETROLEUM CONSERVATION MEASURES,
DIRECT PRICE CONTROLS, AND UNEMPLOYMENT BURDENSARING.
THESE SOURCES BELIEVE THAT SEVERAL FACTORS RULE OUT THE
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APPLICATION OF BROAD ANTICYCLICAL MONETARY AND FISCAL

POLICIES. FIRST, LUXEMBOURG HAS LITTLE CONTROL OVER THE MAJOR MONETARY AGGREGATES SINCE THESE ARE DETERMINED BY ITS BELGIAN PARTNER IN THE MONETARY UNION. INTEREST RATES IN LUXEMBOURG, HOWEVER, DO DIFFER SLIGHTLY FROM THOSE IN BELGIUM AND GOL AUTHORITIES HAVE LIMITED POLICY TOLLS TO SET INTEREST RATES AND RESTRICT CREDIT TERMS, PARTICULARLY IN THE LONG TERM MARKETS SUCH AS CONSTRUCTION AND MORTGAGE LOANS. SECOND, THE OPEN NATURE OF THE ECONOMY (IMPORTS ARE EQUAL TO 80 PERCENT AND EXPORTS 82 PERCENT OF GNP) SEVERELY LIMITS THE EFFECTIVENESS OF TAXATION AND EXPENDITURE POLICIES. THIS ECONOMIC DEPENDENCE ON OTHER NATIONS IS COUPLED WITH A POLITICAL RELUCTANCE TO TAMPER WITH THE RECENTLY VOTED 1974 BUDGET A FEW MONTHS PRIOR TO PARLIAMENTARY ELECTIONS.

2) FULLY AWARE THAT ITS ECONOMIC FORTUNES DEPEND UPON ECONOMIC TRENDS IN ITS MAJOR MARKETS (FRANCE, GERMANY, BELGIUM), THE GOL HAS TAKEN THE FOLLOWING MEASURES TO ASSURE AN EQUITABLE DISTRIBUTION OF ANY ECONOMIC BURDEN RESULTING FROM THE PETROLEUM SHORTAGES AN PRICE INCREASES AND TO AMELIORATE ECONOMIC DISTORTIONS THAT MAY DEVELOP.

A) A DECEMBER 1973 LAW GRANTS BROAD POWERS TO THE ECONOMIC MINISTER FOR ONE YEAR TO TAKE MEASURES TO CONSERVE ENERGY SUPPLIES. THESE POWERS ENABLE THE MINISTER TO CONTROL THE DISTRIBUTION, PURCHASE, SALE, TRANSPORTATION, AND STOCKS OF PETROLEUM PRODUCTS. THE MINISTER IS AUTHORIZED TO TAKE MEASURES OF A GENERAL NATURE AS WELL AS THOSE DIRECTED AT SPECIFIC SECTORS OF THE ECONOMY. THESE POWERS HAVE BEEN USED SPARINGLY THUS FAR AND CONSERVATION MEASURES IN FORCE ARE SIMILAR TO THOSE TAKEN BY BELGIUM (I.E., DRIVING BANS AND LOWER SPEED LIMITS, CLOSING OF GAS STATIONS ON WEEKEND, POOLING OF PERCENTAGE OF FUEL OIL BY MAJOR DISTRIBUTORS FOR USE BY INDEPENDENT DISTRIBUTORS). ALL OF THESE MEASURES HAVE BEEN TAKEN IN CLOSE COOPERATION WITH THE BELGIANS WHO HAVE ASSURED THE GOL THAT LUXEMBOURG WILL BE TREATED EQUALLY WITH BELGIUM IN OBTAINING PETROLEUM SUPPLIES (LUXEMBOURG IS DEPENDENT UPON BELGIAN REFINERIES

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FOR NEARLY 70 PERCENT OF ITS PETROLEUM NEEDS.)

B) PRICE CONTROLS. EXISTING LEGISLATION PERMITS THE MINISTER OF THE ECONOMY TO ESTABLISH MAXIMUM PRICES FOR ALL PRODUCTS AND TO LIMIT PROFIT MARGINS IN INDIVIDUAL SECTORS OF THE ECONOMY. UNDER THIS AUTHORITY THE PRICES OF PETROLEUM PRODUCTS AS WELL AS THOSE OF SEVERAL FOODSTUFFS WERE CONTROLLED PRIOR TO THE PETROLEUM CRISIS

AND CONTINUE TO BE CONTROLLED. THE GOL HAS USED THE AUTHORITY OF THIS LAW IN THE PAST TO COMBAT INFLATIONARY TENDENCIES IN THE ECONOMY AND IS PREPARED TO MAKE INCREASED USE OF ITS PRICE-SETTING POWERS AS THE SITUATION WARRANTS. ECONOMY MINISTRY OFFICIALS REALIZE THAT THE OPENNESS OF ECONOMY PREVENTS THEM FROM INSULATING THE ECONOMY FROM PRICE INCREASES IN NEIGHBORING COUNTRIES, PARTICULARLY THOSE INCREASES IN THE PRICE OF TRADED GOODS ON WHICH THEY SO HEAVILY DEPEND. THEY HOPE, HOWEVER, TO LIMIT PRICE INCREASES TO THOSE THAT ARE JUSTIFIED BY INCREASED COSTS AND TO ELIMINATE ATTEMPTS TO USE INCREASED PRICES OF INPUT AS AN EXCUSE TO INFLATE PROFIT MARGINS VIA GREATER PRICE INCREASES IN FINISHED AND TRADED PRODUCTS THAN ARE JUSTIFIED BY THE INCREASED COST OF ENERGY AND RAW MATERIALS. MINISTRY OFFICIALS BELIEVE THAT THIS POLICY CAN BE EFFECTIVE BECAUSE OF THE SMALLNESS AND "TRANSPARENCY" OF THE LUXEMBOURG ECONOMY.

GQL EMPLOYMENT POLICY.

THE LUXEMBOURG ECONOMY HAS BEEN FULLY EMPLOYED FOR SEVERAL YEARS. THE LABOR SHORTAGE IN SOME SKILLED AREAS (I.E., BANKING) IS SO ACUTE THAT THE GOVERNMENT INSISTS THAT NEW FOREIGN ESTABLISHMENTS RECRUIT THEIR TOP LEVEL MANAGEMENT FROM OUTSIDE LUXEMBOURG. DUE TO THE NEAR ZERO GROWTH RATE IN THE NATIVE BORN LABOR FORCE, LUXEMBOURG HAS DEPENDED ALMOST ENTIRELY UPON IMMIGRATION TO INCREASE ITS LABOR FORCE AND THE PERCENTAGE OF FOREIGNERS IN THE LABOR FORCE IS NOW CLOSE TO 20 PERCENT. MINISTER MART, THE ECONOMIC MINISTER, HAS INDICATED TO US THAT HE DOES NOT NOW PLAN TO CURTAIL THE IMMIGRATION OF FOREIGN WORKERS AND THAT THE GOL HAS ESTABLISHED

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FM AMEMBASSY LUXEMBOURG
TO SECSTATE WASHDC IMMEDIATE 3717
INFO AMEMBASSY BRUSSELS

C O N F I D E N T I A L FINAL SECTION OF 2 LUXEMBOURG 0038

C. ECONOMIC PROJECTIONS.

1) OFFICIALS OF THE LUXEMBOURG STATISTICAL OFFICE (STATEC) HAVE NOT YET MADE OFFICIAL POST DECEMBER PROJECTIONS FOR 1974. THEY POINT OUT THAT PROJECTIONS FOR THE LUXEMBOURG ECONOMY DEPEND IN LARGE MEASURE UPON PROJECTIONS MADE FOR THE FRENCH, GERMAN AND BELGIAN ECONOMIES SINCE LUXEMBOURG PRODUCTION, EXPORTS AND GNP DEPEND PRIMARILY ON DEVELOPMENTS IN THOSE THREE MARKETS. THE LUXEMBOURG ECONOMY DEPENDS TO A LARGE EXTENT ON STEEL PRODUCTION (46 PERCENT OF INDUSTRIAL PRODUCTION) AND CHEMICAL AND TIRE PRODUCTION (20 PERCENT OF INDUSTRIAL PRODUCTION), WITH 95-100 PERCENT OF THIS PRODUCTION DESTINED FOR MARKETS OUTSIDE OF LUXEMBOURG. PREDICTIONS FOR THE LUXEMBOURG ECONOMY THUS DEPEND LARGELY ON PREDICTIONS FOR THE WORLD STEEL MARKET AND THE EUROPEAN AUTOMOBILE AND CONSTRUCTION MARKETS, ON THE DEMAND SIDE, AND UPON THE PRICE AND AVAILABILITY OF PETROLEUM BASED RAW MATERIALS ON THE SUPPLY SIDE.

2) IN THE BASENCE OF DETAILED PROJECTIONS FOR
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NEIGHBORING ECONOMIES, THE LUXEMBOURG STATISTICAL OFFICE HAS DEVELOPED THREE ALTERNATIVE HYPOTHESES THAT RANGE FROM A 1974 REDUCTION IN GNP REAL GROWTH OF MINUS 2.5 PERCENT TO AN INCREASE OF PLUS 1.5 PERCENT. MOST SOURCES INDICATE THAT THEIR BEST ESTIMATE IS FOR ZERO GROWTH IN 1974.

Q) THE MOST PESSIMISTIC HYPOTHESIS ASSUMES THAT STEEL PRODUCTION RETURNS TO ITS 1972 LEVEL (A DECREASE OF APPROXIMATELY 8 PERCENT) AND THAT THE TIRE, CHEMICAL AND METAL FABRICATION INDUSTRIES SUFFER 15 PERCENT, 10 PERCENT AND 6 PERCENT REDUCTION, RESPECTIVELY, IN VOLUME. IN THIS CASE, REAL GNP WOULD DECREASE BY 2.5 PERCENT.

B) THE SECOND HYPOTHESIS ASSUMES A REDUCTION IN STEEL PRODUCTION SIMILAR TO THAT IN 1971 (K.E., MINUS 4 PERCENT) AND DECREASES OF 8 PERCENT, 5 PERCENT AND 3 PERCENT IN THE TIRE, CHEMICAL AND METAL FABRICATION INDUSTRIES, RESPECTIVELY. IN THIS CASE, REAL GNP WOULD STAGNATE AT ZERO GROWTH.

C) THE THIRD VARIANT ASSUMES THE STEEL PRODUCTION REMAINS AT THE 1973 LEVEL (I.E., NEAR FULL CAPACITY) AND THAT THERE ARE ONLY SLIGHT REDUCTIONS IN THE TIRE AND METAL FABRICATION INDUSTRIES OF 5 PERCENT AND 3 PERCENT. IN THIS CASE REAL GNP WOULD INCREASE BY 1.5 PERCENT.

3) PRELIMINARY FIGURES FOR 1973 INDICATE A REAL GROWTH IN GNP OF APPROXIMATELY 7.2 PERCENT, ONE OF THE BEST GROWTH YEARS SINCE WWII. ORIGINAL ESTIMATES FOR 1974 PREDICTED A GRWOTH RATE OF 3.3 PERCENT IN REAL TERMAS.

4) STATISTICAL OFFICE ECONOMISTS INDICATE THAT THE CONSUMER PRICE INDEX IS EXPECTED, AS A RESULT OF THE INCREASE IN PETROLEUM PRICES, TO RISE BY 8-9 PERCENT IN 1974 AS COMPARED TO 6.1 PERCENT IN 1973. THE STATISTICAL OFFICE HAS NOT MADE ANY PROJECTIONS OF THE IMPLICIT GNP PRICE DEFLATOR FOR 1974 DUE TO ITS LACK OF ESTIMATES FOR THE TREND OF STEEL PRICES IN
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1974. THE PRICE OF STEEL ACCOUNTS FOR A LARGE SHARE OF THE YEAR TO YEAR VARIATION IN THE IMPLICIT DEFLATOR (STEEL PRODUCTION IS 26 PERCENT OF NP). IN 1973 THE IMPLICIT PRICE DEFLATOR INCREASED BY 11.5 PERCENT.

5) PRELIMINARY ESTIMATES OF THE TRADE BALANCE INDICATE A TRADE SURPLUS OF 2.7 BILLION BF IN 1973 AND A SURPLUS ON CURRENT ACCOUNT OF 4.1 BILLION BF. THE INTERNATIONAL CCOUNTS OF BELGIUM AND LUXEMBOURG ARE INTEGRATED AND THESE FIGURES REPRESENT AN EXTRAPOLATION FOR LUXEMBOURG BY ECONOMISTS AT THE STATISTICAL OFFICE. THE FAVORABLE BALANCE REPRESENTS A SUBSTANTIAL INCREASE FROM 1973 AND IS ACCOUNTED FOR IN LARGE PART BY BOTH THE INCREASED VOLUME AND INCREASED PRICES OF STEEL EX-PORTS. THE INCREASED PRICES OF PETROLEUM PRODUCTS IS ESTIMATED TO DEDUCT 2 BILLION BF FROM THE TRADE AND CURRENT ACCOUNT BALANCES IN 1974. AGAIN, NO PROJECTIONS OF THE TOTAL 1974 TRADE BALANCE HAVE BEEN MADE PENDING REVISED FIGURES ON THE OUTLOOK FOR THE WORLD STEEL MARKET. LUXEMBOURG STATEC ECONOMISTS INFORMALLY EXPECT, HOWEVER, THAT LUXEMBOURG WILL MAINTAIN AN EQUILIBRIUM OR A SLIGHT SURPLUS ON TRADE AND CURRENT ACCOUNTS.

D). SHORTAGES. CONSERVATION MEASURES TAKEN BY THE GOVERNMENT HAVE PROVEN SUCCESSFUL IN MEETING GASOLINE AND FUEL OIL NEEDS. THE STEEL INDUSTRY REPORTS SUFFICIENT OIL TO MAINTAIN CURRENT LEVELS OF PRODUCTION AND MINISTRY OF ECONOMY OFFICIALS STATE THAT THERE IS

NO SHORTAGE OF GASOLINE OR HOME FUEL OIL.

2) SEVERAL AMERICAN CHEMICAL FIRMS, HOWEVER, REPORT DIFFICULTIES IN OBTAINING PETROLEUM BASED RAW MATERIALS SUCH AS PROPANE, ETHYLENE AND NYLON SALT WITH A RESULTING DECREASE IN PRODUCTION. ONE FIRM IS OPERATING AT 80 PERCENT OF PREVIOUS PRODUCTION LEVELS AND SOME OTHERS HAVE SUFFERED SMALLER REDUCTIONS. ALL OF THESE FIRMS ARE COMBATTING INCREASED PETROLEUM PRICES AND REDUCED SUPPLIES BY ALTERING PRODUCTION PROCESSES OR CHANGING THEIR OUTPUT MIX (I.E., SUBSTITUTING BUTANE FOR PROPANE, PRODUCING TEXTILE FIBER NEEDING LOWER
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INPUTS OF NYLON SALT) WHERE POSSIBLE AND REEVALUATING EXPANSION PLANS.

3) TO DATE THERE HAVE BEEN NO LAYOFFS RELATED TO THE CHANGED PETROLEUM SITUATION, AND THE ECONOMY IS STILL OPERATING AT FULL EMPLOYMENT. INDUSTRIAL WAGE INCREASES IN 1974
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